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CHARLES ELMORE

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No. 761- 762

IN THE MATTER OF
FRANKLIN BUILDING COMPANY,
*Debtor.*

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
*Petitioner,*

*vs.*

ROBERT W. SCHROEDER,
*Respondent.*

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
*Petitioner,*

*vs.*

MOLLIE SCHROEDER AND JUNE KUPTZ,
*Respondents.*

## PETITION FOR WRITS OF CERTIORARI AND SUPPORTING BRIEF

JOHN W. EMMERLING, *Trustee of* FRANKLIN BUILDING COMPANY
633 North Water Street
Milwaukee 2, Wisconsin,
*Petitioner, pro se.*

JACKSON M. BRUCE,
*Of Counsel.*

HAMMERSMITH-KORTMEYER CO. MILWAUKEE

## SUBJECT INDEX


Page

PETITION FOR WRITS OF CERTIORARI

Summary Statement of the Matter Involved ..... 2

Statement as to Jurisdiction ..... 4

Questions Presented ..... 4

Reasons Relied on For Allowance of Writs:

1. The Court of Appeals has in this case decided (in the negative) an important question of Federal Law which has not been, but should be, settled by this Court, namely: Should the claims of close relatives of a fiduciary who purchased their bonds for them, (a) pursuant to a joint enterprise in which he and they participated; or (b) as their agent acting under broad express authority, be limited to the cost of the bonds? ..... 4

2. The Court of Appeals for the Seventh Circuit has in this case rendered a decision in conflict with the decisions of the Courts of Appeals for the Second Circuit in *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121 (1934), cert. den. *sub nom. Bell v. Irving Trust Company,* 294 U.S. 709; and for the Sixth Circuit in *In re Van Sweringen Co.,* 119 F. (2d) 231 (1941), cert. den. sub. nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.,* 314 U.S. 671 ..... 4

3. The Court of Appeals for the Seventh Circuit has in this case rendered a decision in conflict with the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.,* 159 F. (2d) 340 (1947) ..... 5

Page

SUPPORTING BRIEF

The Opinions in the Court Below ..... 7

Statement as to Jurisdiction ..... 8

Statement of the Case ..... 8

Specification of Errors ..... 17

Argument:

I. These Claims should be Limited to Cost Because the Claimants are close Relatives of a Fiduciary who purchased their bonds for them, (a) Pursuant to a Joint Enterprise in which he and they Participated; or (b) As their Agent Acting under Broad Express Authority ..... 18

II. This Decision is in Conflict with the Decisions of the Court of Appeals for the Second Circuit in *Irving Trust Co. v. Deutsch* and for the Sixth Circuit in *In re Van Sweringen Co.* ..... 27

III. This Decision is in Conflict with the Decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.* ..... 31

Conclusion ..... 36

CASES CITED

American United Mutual Life Insurance Co. v. Avon Park, 311 U.S. 138 (1940) ..... 23

Berner v. Equitable Office Bldg. Corporation, 175 F. (2d) 218 (1949) ..... 33-34

Emery v. Parrott, 107 Mass. 95 ..... 29

Page

Holman v. Ryan, 56 F. (2d) 307 (1932) ..... 33

Irving Trust Co. v. Deutsch, 73 F. (2d) 121 (1934), cert. den. *sub nom.* Bell v. Irving Trust Company, 294 U.S. 709 .....4, 25, 26, 28

Jackson v. Smith, 254 U.S. 586 (1921) .....28, 29

Jersey Materials Co., In re, 50 F. Supp. 428 (1943).. 26

Lomita Land & Water Co. v. Robinson, 154 Cal. 36, 97 Pac. 10, 18 L.R.A. (N.S.) 1106 ..... 29

Los Angeles Lumber Products Company, Ltd., In re, 46 F. Supp. 77 (1941) ..... 26

Magruder v. Drury, 235 U.S. 106 (1914).....22, 29

Manufacturers Trust Company v. Becker, 338 U.S. 304 (1949) .....18, 23

Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 62 A.L.R. 1 (1928) .....22, 27

Michoud v. Girod, 4 How. 503 ..... 29

Midland United Co., In re, 159 F. (2d) 340 (1947)..5, 32

Norcor Mfg. Co., In re, 109 F. (2d) 407 (1940), cert. den. 310 U.S. 625 ..... 30

Pepper v. Litton, 308 U.S. 295 (1939) .....22, 26

Van Sweringen Co., In re, 119 F. (2d) 231 (1941), cert. den. *sub nom.* Terminal & Shaker Heights Realty Co. v. Van Sweringen Co., 314 U.S. 671 .....4, 26, 28, 30

Woods v. City Nat. Bank & Trust Co. of Chicago, 312 U.S. 262 (1941) ..... 23

Zinc Carbonate Co. v. First National Bank, 103 Wis. 125, 79 N.W. 229, 74 Am. St. Rep. 845..... 29

Page

TEXT BOOKS CITED

3 Bogert, Trusts and Trustees, Sec. 485, pp. 109-111 25

3 Bogert, Trusts and Trustees, Sec. 543, pp. 375-376 25

6 Collier on Bankruptcy, 14th ed., Sec. 9.28, pp. 2920-2922 ..... 34

6 Collier on Bankruptcy, 14th ed., Sec. 9.28, pp. 2921-2922 ..... 34

6 Collier on Bankruptcy, 14th ed., Sec. 9.28, page 2923 ..... 25

6 Collier on Bankruptcy, 14th ed., Sec. 9.31, page 2929 ..... 35

6 Collier on Bankruptcy, 14th ed., Sec. 9.31, pp. 2933-2934 ..... 35

6 Collier on Bankruptcy, 14th ed., Sec. 13.18, pp. 4584-4585 ..... 34

6 Collier on Bankruptcy, 14th ed., Sec. 13.18 pp. 4584-4586 ..... 35

6 Collier on Bankruptcy, 14th ed., Sec. 13.18, page 4590 ..... 34-35

1 Restatement, Trusts, Sec. 170, p. 431 ..... 25

1 Restatement, Trusts, Sec. 170, Comments j and k, pp. 437-438 ..... 25

1 Restatement, Trusts, Sec. 206, Comment i, page 563 ..... 25

STATUTES CITED

Bankruptcy Act, Section 212 (11 USCA, Sec. 612) ..... 31-32

Page

Bankruptcy Act, Section 249 (11 USCA, Sec. 649) ..... 32

MISCELLANEOUS

House Report No. 1409, 75th Cong., 1st Sess. (1937), p. 37 ..... 34

IN THE

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No.

IN THE MATTER OF

FRANKLIN BUILDING COMPANY,

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JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,

*Petitioner,*

*vs.*

ROBERT W. SCHROEDER,

*Respondent.*

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,

*Petitioner,*

*vs.*

MOLLIE SCHROEDER AND JUNE KUPTZ,

*Respondents.*

## PETITION FOR WRITS OF CERTIORARI

*To the Honorable, the Justices of the Supreme Court of the United States:*

The petition of John W. Emmerling, Trustee of Franklin Building Company, for writs of certiorari to the Court of Appeals for the Seventh Circuit in the above-

entitled causes, respectfully shows to this Court as follows:

## SUMMARY STATEMENT OF THE MATTER INVOLVED[1]

This petition involves the claims of Mollie Schroeder, Robert Schroeder, and June Kuptz, who are respectively the wife, son, and daughter of William Schroeder, upon first mortgage bonds issued by Franklin Building Company, debtor. Objections to these claims were filed in the proceedings for the reorganization of debtor under Chapter X of the Bankruptcy Act by the trustee appointed in those proceedings, who is the petitioner herein. The objections to these claims were overruled by the District Court, and they were allowed in full, although William Schroeder's claim on his own bonds was limited to cost. There was no appeal as to his claim, but the determination as to these claims was affirmed upon appeal to the Court of Appeals for the Seventh Circuit.

The evidence in the hearing under the Sections 21(a) and 167 of the Bankruptcy Act prior to the objections and in the hearing on the objections established that William Schroeder purchased all or virtually all of the bonds included in these claims for the respective claimants, but the funds used belonged to the latter. It is this petitioner's contention that the evidence further established that the bonds were purchased pursuant to a joint enterprise participated in by William Schroeder and his family, or at least were purchased by him as their agent acting under broad express authority given to him by them. It appeared without dispute that at the time all of the

[1] A more detailed discussion of the evidence, together with citations to the Record, appears in the Statement of the Case in the annexed supporting brief, and is incorporated herein.

bonds were purchased William Schroeder owned one-third of debtor's outstanding stock, was president and a director of debtor corporation, and was the agent in charge of the operation of its entire business. After November, 1944, during the time when some 85% of these bonds were purchased, William Schroeder was also a member of the Bondholders Committee which had been created in 1932 and which had taken over and operated all of the assets and business of the debtor until the appointment of the trustee in the present proceedings in July, 1947. The bonds that were purchased while Mr. Schroeder was a member of the Bondholders Committee were also purchased during the pendency of involuntary Chapter X proceedings, in which the Committee was continued in possession, which were dismissed on stipulation on the same day that the present voluntary proceedings were filed on petition of the debtor.

The bonds owned by these claimants were purchased during the years 1941 to 1947 at prices ranging from 9% to 60% of the face amount. Mollie Schroeder owns $10,000 in face amount bought at a total cost of $3,780.00; Robert Schroeder, $8,300 bought for $3,494.00 and $2,100 as to which he has no records or recollection; June Kuptz, $4,500 bought at a cost of $2,270.00. Distribution in the reorganization proceedings will be 100% of the principal principal of first mortgage bonds plus at least 40% on account of accrued interest. Potential profits to these claimants are thus $10,220.00 to Mollie Schroeder; $10,181.90 to Robert (assuming the bonds as to which he has no information cost the same, on the average, as his other bonds), and $4,030.00 to June Kuptz, a total of $24,431.90.

## STATEMENT AS TO JURISDICTION

Jurisdiction of this Court to review this case is based upon Section 1254 of the Judicial Code as amended (28 U.S.C.A., Sec. 1254).

## QUESTION PRESENTED

The only question presented is whether the claims of Mollie Schroeder, Robert Schroeder, and June Kuptz should be limited to the cost of their bonds.

## REASONS RELIED ON FOR ALLOWANCE OF WRITS

1. The Court of Appeals has in this case decided (in the negative) an important question of federal law which has not been, but should be, settled by this Court, namely: Should the claims of close relatives of a fiduciary who purchased their bonds for them, (a) pursuant to a joint enterprise in which he and they participated; or (b) as their agent acting under broad express authority, be limited to the cost of the bonds?

2. The Court of Appeals for the Seventh Circuit has in this case rendered a decision in conflict with the decisions of the Courts of Appeals for the Second Circuit in *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121 (1934), cert. den. sub nom. *Bell v. Irving Trust Company,* 294 U.S. 709, and for the Sixth Circuit in *In re Van Sweringen Co.,* 119 F. (2d) 231 (1941), cert. den. sub nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.,* 314 U.S. 671.

In both of those cases it was held that a person who knowingly joins with a fiduciary in his breaches of trust is accountable for any resulting profits. Here it is un-

disputed that William Schroeder was a fiduciary; these claimants joined with him in the purchase of their bonds; yet the Court of Appeals allowed them their full profits.

3. The Court of Appeals for the Seventh Circuit has in this case rendered a decision in conflict with the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.*, 159 F. (2d) 340 (1947).

In that case it was held that Section 249 of the Bankruptcy Act prohibits the allowance of compensation to a fiduciary whose wife traded in the debtor's securities. The purpose of Section 212 is the same as the purpose of Section 249; it is undisputed that William Schroeder's family traded in debtor's bonds; yet the Court of Appeals refused to limit their claims under Section 212.

*Wherefore,* your petitioner respectfully prays that Writs of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court, on a day certain to be therein designated, a full and complete transcript of the record and all proceedings in these cases, which were entitled in that Court: *"In the Matter of Franklin Building Company, a Corporation, Debtor:* Cause No. 9843, *John W. Emmerling, Trustee of Franklin Building Company, Appellant, vs. Robert W. Schroeder, Claimant-Appellee;* and Cause No. 9844, *John W. Emmerling, Trustee of Franklin Building Company, Appellant, vs. Mollie Schroeder and June Kuptz, Claimants-Appellees",* Appeals from the District Court of the United States for the Eastern District of Wisconsin, to the end that said causes may be reviewed and determined by this Court as provided by law; and that your petitioner may have such other and further relief or remedy in the

premises as to this Court may seem just and appropriate; and that the said judgments of the Court of Appeals may be reversed by this Honorable Court.

JOHN W. EMMERLING, *Trustee of*
FRANKLIN BUILDING COMPANY,
*Petitioner, pro se.*

JACKSON M. BRUCE,
*Of Counsel.*

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## BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

### THE OPINIONS IN THE COURT BELOW

The majority and dissenting opinions in the court below are reported at 178 F. (2d) 805 and at R. 203-209.

## STATEMENT AS TO JURISDICTION

Jurisdiction of this Court to review this case is based upon Section 1254 of the Judicial Code as amended (28 U.S.C.A., Sec. 1254).

## STATEMENT OF THE CASE

These matters arise out of proceedings in the United States District Court for the Eastern District of Wisconsin for the reorganization of Franklin Building Company, a Wisconsin corporation, debtor, under Chapter X of the Bankruptcy Act. The petitioner herein, who was appointed trustee in the reorganization proceedings on July 9, 1947, filed objections to the claims of eight persons (including these respondents—R. 122-130) on first mortgage bonds issued by debtor, and asked that the District Court limit their claims to the actual cost of their bonds. After hearing the court filed its written opinion (R. 173-180), in which it directed the limitation of the claims of four of the claimants, including William Schroeder, the husband of Mollie Schroeder and father of Robert Schroeder and June Kuptz (R. 52, 97, 106). However, the court directed that the claims of Mollie Schroeder, Robert Schroeder, and June Kuptz be allowed in full. Pursuant to the opinion, orders were entered allowing in full the claims of Mollie Schroeder and June Kuptz (R. 181) and the claim of Robert Schroeder (R. 182). These orders were appealed by the petitioner-trustee on the same record (R. 188-191); they were affirmed by the decision of the Court of Appeals for the Seventh Circuit.

Franklin Building Company was organized as a Wisconsin corporation in 1927 (R. 2). William Schroeder was one of the organizers, and has at all times owned

one-third of the $51,000 in common stock which was issued by the company. He was also a director of the company and its president for substantially all of its history (R. 81-82). The company commenced erection of an office building in the City of Milwaukee in 1929, but construction ceased in 1930 before the building was completed (R. 39, 153).[2] To finance the building it executed a first mortgage securing 6½% bonds in the amount of $250,000, all of which were issued, and a second mortgage to secure 7½% bonds in the amount of $60,000, of which $52,300 were sold (R. 174). Before the building was completed the company ran out of funds, and in later years between $50,000 and $100,000 was expended to finish construction (Exs. C, D, E, F, P, Q; R. 2-3, 39, 153).

At the time that construction of the building was halted, unpaid accounts due to contractors and other suppliers and creditors amounted to more than $50,000 (Ex. C). Real estate taxes for the year 1930 had been paid, but 1931 real estate taxes were not paid until many years later (Ex. C, P, Q), and the non-payment of these taxes when due was the first default under the first mortgage trust indenture (Ex. 3). By the summer of 1932, payments upon the 99-year ground lease of the land upon which the building was constructed were in default and it was apparent that the company would be unable to pay the interest coupons on first mortgage bonds which would come due on November 1, 1932 (R. 23, 137).

The result of the precarious condition of the company in the summer of 1932 was a meeting of bondholders in August of that year, at which a Bondholders Committee

[2] The completed portions of the building were offered for rent to tenants, but there is no evidence in the Record as to occupancy or income before September 1, 1932.

was formed (R. 23). On August 31, 1932, the debtor corporation executed to the Bondholders Committee's trustee an assignment of all of its past-due and future rental and other income (Ex. 3, par. 6; R. 24). On the same date a Trust Agreement was entered into by the debtor and the committee (Ex. 3; R. 25, 151); its material provisions are summarized in the margin.[3] In addition, powers of attorney, of which Exhibit 4 is typical, were obtained from a large percentage of the bond-

[3] The Trust Agreement provided:

1. The entire management and control and operation of the company's property was vested in a trustee to be chosen by the Bondholders Committee; and the trustee was made subject to removal by the committee and all his acts were made subject to its approval (Par. 1).

2. The Trust Agreement provided that it should remain in effect for a period of five years and should be continued for an additional period of five years unless all taxes, ground rent, and interest on the bonds of the company should have been paid for one year at the rate of 5% per annum. It provided that the committee should hold office for the same period and that vacancies should be filled by the committee unless the holders of 10% in amount of the outstanding bonds should demand that the selection of a successor be made directly by the bondholders (Par. 2).

3. The duties and powers of the trustee included management of the building and collecting rents and income; paying operating expenses; employing help; paying taxes, ground rent, repairs, interest, and other expenses; bringing actions to collect money due to the company; appointing and compensating a rental agent; and preparing complete and comprehensive annual financial reports of the income and expenses of the building and all money collected or paid out and delivering copies thereof to the parties to the Trust Agreement (Par. 3).

4. Franklin Building Company assigned all past due and future rents and other income to the Trustee (Par. 6).

5. The income derived from the operation of the building and all other money coming into the hands of the Trustee was to be expended as follows: (a) For the necessary operating expenses of the building; (b) For the payment of taxes; (c) For the payment of ground rent; (d) For the payment of interest; (e) For the payment of claims of unsecured creditors; (f) For the purchase of First Mortgage Bonds as provided in Paragraph 11 (Par. 7).

6. No interest was to be paid on bonds unless the net income of the building, after payment of operating expenses, taxes, and ground rent, should be sufficient to pay interest, and then only at the discretion of the Bondholders Committee, with certain maximum rates provided; or, in-

holders; these authorized the execution of the trust agreement (R. 26).

On September 1, 1932, the Bondholders Committee took over all of the assets and business of debtor pursuant to the Trust Agreement and commenced operation of debtor's building and business; it continued such operation in the same manner until the appointment of the trustee in the reorganization proceedings on July 9, 1947 (R. 26, 34).[4] When the committee took over, there was no money in the bank, all rents were tied up by garnishment proceedings, as was the bank account, and the electric power and gas were about to be shut off (R. 39, 137). In addition, real estate taxes and payments on the ground lease were in default, there were no funds available for payment of interest on either of the bond issues, and the amount due on construction of the building was still over $50,000 (Ex. 3, C; R. 39, 137).

During the years from 1932 through 1947, operation of the debtor's business resulted in a net loss during each year; the losses varied between $10,000 and $30,000 on

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stead of paying interest, the committee was authorized to redeem First Mortgage Bonds (Par. 8).

7. "If and when the said Committee shall have money on hand after the payment of cost of operation of said building, and all taxes and ground rent, and such interest as they shall have decided to pay to the first and second mortgage bondholders, such money shall be used for the purchase and redemption of first mortgage bonds on the open market at the best price obtainable and if bonds cannot be obtained on the open market at less than par then first mortgage bonds shall be redeemed by lot from all outstanding first mortgage bonds." (Par. 11).

[4] By its terms the Trust Agreement remained in force for five years and for an additional five-year period because the conditions for its termination had not been met in the first five years. It contained no provision for extension after September 1, 1942, but the committee decided to continue to operate the business, and probably advised the bondholders accordingly. In 1946 and 1947 a ratification of this action was obtained from some of the bondholders (R. 27).

an annual basis (Ex. C, Q).[5] Unpaid real estate taxes and penalties increased to more than $42,000 in 1936, reached a slightly higher figure in 1938, and then were gradually reduced until they were paid currently in 1944 (Ex. C).[6]

[5] The following is a tabulation, taken from the figures in Exhibits C and Q, showing the net loss from operations in each year, after deduction of accrued interest, depreciation on debtor's building, and amortization of the leasehold, but adjusted to include as expenses only the real estate taxes which came due during the respective years:

| *Years* | *Net Loss* |
|---|---|
| 1932, Sept. 1 to Dec. 31 | $ 11,500.99 |
| 1933 | 30,872.05 |
| 1934 | 27,689.53 |
| 1935 | 24,235.44 |
| 1936 | 22,373.81 |
| 1937 | 23,875.45 |
| 1938 | 21,148.71 |
| 1939 | 16,197.95 |
| 1940 | 15,786.77 |
| 1941 | 16,337.05 |
| 1942 | 18,156.91 |
| 1943 | 18,739.57 |
| 1944 | 21,348.95 |
| 1945 | 19,292.74 |
| 1946 | 12,449.77 |
| 1947, Jan. 1 to May 4 | 5,320.34 |

[6] The following is a tabulation, taken from Exhibit C, showing the unpaid balance of taxes, interest and penalties, and loan used for refinancing taxes in 1942, as of the ends of the years 1932 through 1943:

| *Year* | *Unpaid Taxes* |
|---|---|
| 1932 | $ 20,984.96 |
| 1933 | 29,235.81 |
| 1934 | 37,269.17 |
| 1935 | 40,999.93 |
| 1936 | 42,413.90 |
| 1937 | 38,984.05 |
| 1938 | 42,545.47 |
| 1939 | 37,033.52 |
| 1940 | 28,509.59 |
| 1941 | 21,456.26 |
| 1942 | 16,834.30 |
| 1943 | 10,483.88 |

One bondholder brought action on his bonds, and as a result in 1934 he obtained payment in full on $5,000 in face amount (Ex. P, Q). At a meeting of the bondholders on January 13, 1936, there was talk of foreclosure by the trustee under the First Mortgage Trust Indenture, receivership, and a plan to refinance unpaid real estate taxes (Ex. 1, pp. 2-3). On February 4, 1937, debtor filed a voluntary petition for reorganization under Section 77B of the Bankruptcy Act which was dismissed shortly later as not having been filed in good faith (R. 114). Around the middle of 1937 William Schroeder became managing agent of debtor's business under the direction of the trustee for the Bondholders Committee, and he continued as such until the institution of the present proceedings, attending to the day-to-day operation of the building (R. 82). The minutes of the Bondholders Committee (Ex. 1, 2) indicate that thereafter Mr. Schroeder regularly attended its meetings. On June 2, 1938, at a meeting of the Bondholders Committee, Mr. Schroeder and the members of the Committee agreed that neither second mortgage bondholders nor stockholders had any more equity in the company (Ex. 1, p. 57). At a meeting of the Bondholders Committee on May 21, 1941, "A proposed reorganization of the company under Chapter X was discussed generally without any commitment" (Ex. 1, p. 84). The same subject was discussed at another meeting on July 23, 1941 (Ex. 1, p. 85).

On November 30, 1943, a group of creditors instituted involuntary reorganization proceedings under Chapter X (R. 114). The Bondholders Committee was continued in possession, and operation of the debtor's business continued as before under the committee, its trustee, and Mr. Schroeder during the pendency of the proceedings (R.

26-27, 34, 82). The bonds of the creditors who instituted those proceedings were purchased from them on February 25, 1946, as a result of negotiations conducted by William Schroeder over a period of years, but the proceedings remained pending until May 5, 1947, the date upon which the present voluntary petition was filed, when they were dismissed on stipulation (Ex. 9; R. 57, 97, 114-115).[7]

On November 14, 1944 William Schroeder became a member of the Bondholders Committee, and he continued as such until May 14, 1947, when he was replaced by his son Robert (Ex. 2, pp. 157, 159; R. 29, 52, 83).

Neither William Schroeder nor any of these claimants purchased any first mortgage bonds of debtor at the time of the original issue (Ex. O; R. 83-84). All of the bonds purchased and now owned by Mr. Schroeder and his family were bought between January 7, 1941 and June 6, 1947. A complete schedule of the purchases of the Schroeder family is contained in Exhibit O, the essential parts of which are reproduced in the margin.[8] The facts

[7] $2700 in face amount of these bonds were purchased by Robert Schroeder for $1,620.00 (Ex. 9). William Schroeder carried on "most of the negotiations" and did the "bargaining as to price" (R. 56-57). Others of these bonds were bought by a former associate of William Schroeder; as to this transaction, the latter testified, " * * * we even had to sell him and pick up some bonds cheaper for him to level out the price, because he claimed $600.00 was too much * * * " (R. 94).

[8] Exhibit O: Bonds purchased by William Schroeder, Mollie Schroeder, Robert Schroeder, and June Kuptz:

| *Date Acquired* | *Bond No.* | *Face Amount* | *Price* | *For Whom* |
|---|---|---|---|---|
| 1/ 7/41 | 513 | $1,000 | $100. | Mollie Schroeder |
| 6/25/42 | 51 | 500 | 45. | " " |
| | 131 | 100 | 9. | Robert Schroeder |
| | 170 | 1,000 | 90. | Mollie Schroeder |
| | 401 | 500 | 45. | " " |
| | 493 | 1,000 | 90. | Robert Schroeder |
| 5/24/44 | 248 | 100 | 25. | Mollie Schroeder |

| *Date Acquired* | *Bond No.* | *Face Amount* | *Price* | *For Whom* |
|---|---|---|---|---|
| 12/29/44 | 509 | 1,000 | 310. | Robert Schroeder |
| 10/ 2/45 | 486 | 1,000 | 360. | " " |
| 1/10/46 | 245 | 100 | 45. | " " |
| | 402 | 500 | 225. | " " |
| 2/18/46 | 352 | 500 | 210. | " " |
| 2/25/46 | 34 | 500 | 300. | " " |
| | 82 | 100 | 60. | " " |
| | 133 | 100 | 60. | " " |
| | 217 | 100 | 60. | " " |
| | 234 | 100 | 60. | " " |
| | 239 | 100 | 60. | " " |
| | 240 | 100 | 60. | Robert Schroeder |
| | 246 | 100 | 60. | " " |
| | 253 | 100 | 60. | " " |
| | 254 | 100 | 60. | " " |
| | 277 | 100 | 60. | " " |
| | 297 | 100 | 60. | " " |
| | 319 | 500 | 300. | " " |
| | 341 | 500 | 300. | " " |
| 4/15/46 | 137 | 500 | 215. | " " |
| 5/ 3/46 | 510 | 1,000 | 470. | " " |
| 5/25/46 | 322 | 500 | 225. | June Kuptz |
| | 361 | 500 | 225. | " " |
| 6/ 5/46 | 373 | 500 | 225. | Mollie Schroeder |
| 7/17/46 | 379 | 500 | 300. | " " |
| 9/ 3/46 | 18 | 1,000 | 490. | William Schroeder |
| | 49 | 500 | 245. | " " |
| | 52 | 500 | 245. | " " |
| 10/15/46 | 516 | 1,000 | 500. | Mollie Schroeder |
| 10/30/46 | 192 | 1,000 | 500. | " " |
| | 207 | 500 | 250. | " " |
| 11/ 7/46 | 353 | 500 | 240. | " " |
| | 371 | 500 | 240. | " " |
| 12/13/46 | 110 | 100 | 50. | " " |
| | 111 | 100 | 50. | " " |
| | 267 | 100 | 50. | " " |
| | 268 | 100 | 50. | " " |
| 12/30/46 | 169 | 1,000 | 500. | " " |
| 1/17/47 | 418 | 1,000 | 500. | William Schroeder |
| 1/22/47 | 37 | 1,000 | 480. | " " |
| 2/10/47 | 366 | 500 | 260. | " " |
| 3/28/47 | 466 | 1,000 | 520. | Mollie Schroeder |
| | 467 | 1,000 | 520. | June Kuptz |
| 4/ 7/47 | 368 | 500 | 260. | " " |
| | 465 | 1,000 | 520. | " " |

as to the bonds now owned by these claimants and by Mr. Schroeder may be summarized as follows:

*William Schroeder:* In 1946 and 1947 purchased six bonds of a total face amount of $4,500 at a total cost of $2,220, or 49.3% of the face amount; his distributive share, at 140%, had his claim not been limited, would have been $6,300, for a profit of $4,080, or 90.7% of the face amount of his bonds.

*Mollie Schroeder:* In 1941, 1942, 1944, 1946, and 1947 purchased 18 bonds amounting to $10,000 at a cost of $3,780, or 37.8% of the face amount; her distributive share at 140% would be $14,000, for a profit of $10,200, or 102.2% of the face amount of her bonds.

*Robert Schroeder:* In 1942, 1944, 1945, and 1946 purchased 23 bonds amounting to $8,300 at a cost of $3,494, or 42.1% of the face amount. He also purchased 4 bonds amounting to $2,100 as to which he has no records or recollection of the cost (R. 57-58, 59, 65); assuming these were also acquired at 42.1% of the face amount, his bonds amount to a total of $10,400 at a total cost of $4,378.10. His distributive share at 140% would be $14,560, for a profit of $10,181.90 or 97.9% of the face amount of his bonds.

*June Kuptz:* In 1946 and 1947 purchased bonds amounting to $4,500 at a cost of $2,270, or 50.4% of the face amount; her distributive share at 140% would amount to $6,300, for a profit of $4,030.00 or 89.6% of the face amount of her bonds.

| *Date Acquired* | *Bond No.* | *Face Amount* | *Price* | *For Whom* |
|---|---|---|---|---|
| 6/ 6/47 | 491 | 1,000 | 520. | June Kuptz |
| Unknown | 136 | 500 | Unknown | Robert Schroeder |
| " | 266 | 100 | " | " " |
| " | 357 | 500 | " | " " |
| " | 453 | 1,000 | " | " " |

*The Schroeder Family:* In the years 1941 through 1947, purchased 57 bonds with a total face amount of $29,400 at a cost[9] of $12,648.10, or 43.0% of the face amount; their distributive shares at 140% would total $41,160, resulting in a profit to them of $28,511.90, or 97.0% of the face amount of their bonds.

*These claimants:* Their bonds total $24,900 in face amount and cost $10,428.10,[10] or 41.9%; their distributive shares at 140% would total $34,860.00, for a profit of $24,431.90, or 98.1% of the face amount of their bonds.

## SPECIFICATION OF ERRORS

The Court of Appeals erred in the following respects:

1. In holding that the rules of equity as applied in reorganization proceedings do not require the limitation to cost of bonds owned by close relatives of a fiduciary who purchased their bonds for them either (a) pursuant to a joint enterprise in which he and they participated, or (b) as their agent acting under broad express authority.

2. In holding that the participation of such persons in the breaches of trust of the fiduciary does not also require the limitation to cost of their claims.

3. In holding that Section 212 of the Bankruptcy Act does not require the limitation to cost of bonds owned by close relatives of a fiduciary who purchased their bonds for them either (a) pursuant to a joint enterprise in which he and they participated, or (b) as their agent acting under broad express authority.

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[9] Making the same assumption as to Robert's bonds of which he has no records.

[10] Making the same assumption as to Robert's bonds of which he has no records.

4. In affirming the orders of the District Court overruling the objections to these claims and allowing them in full.

## ARGUMENT

### I.

### These Claims Should Be Limited to Cost Because the Claimants Are Close Relatives of a Fiduciary Who Purchased Their Bonds for Them, (A) Pursuant to a Joint Enterprise in Which He and They Participated; or (B) As Their Agent Acting Under Broad Express Authority.

This case involves a question of federal law which has great importance in the administration of the arrangement and corporate reorganization provisions of the Bankruptcy Act. That question is: Should the claims of close relatives of a fiduciary be limited to cost when it appears that the fiduciary purchased their bonds for them, (a) pursuant to a joint enterprise in which he and they participated; or (b) as their agent acting under broad express authority? The Court of Appeals answered the question in the negative and affirmed the order of the District Court allowing the claims in full. The claim of the fiduciary on his own bonds, however, had been limited by the District Court, and there has been no appeal from that determination.

This Court has recently given clear indication that precisely this same question has not been settled by it. In *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (Nov. 21, 1949), there were before the Court the claims of close relatives of two directors of a corporation which had filed its petition for an arrangement under Chapter XI of the Bankruptcy Act. It appeared that the claim-

ants' debentures "were purchased through the agency of" the directors, "and in the latter's judgment." This Court indicated that in analyzing the propriety of the purchases it would "view the claims initially as if they were claims of directors", but held that, even when so viewed, none of the purchases was improper. Accordingly, in a footnote, the decision was specifically limited: "Thus it becomes unnecessary to determine whether the relation of the Becker respondents to the directors was such as to require limitation of these respondents' claims if they would be disallowed in part as claims of directors." In this case it appears without question that these claimants' bonds were purchased "through the agency of" William Schroeder "and in the latter's judgment."[11] It

[11] William Schroeder testified that he participated in the purchase of at least some of the bonds presently owned by Mollie Schroeder, Robert Schroeder, and June Kuptz, his wife, son, and daughter, and included in their claims (R. 96-97), and that either he or his son bought all of his wife's bonds (R. 100). Neither Mollie Schroeder nor June Kuptz appeared as a witness in any of the proceedings, and all of the evidence as to the acquisition of their bonds was presented by William Schroeder. Not only is there no evidence to indicate that Robert Schroeder purchased any of his sister's bonds, or any of his mother's bonds with the possible exception of three that were billed to him and one that was billed to his father-in-law (Ex. 18, 21), but there is no evidence that he acquired any of his own bonds except his testimony that he "thinks" he handled the negotiations on his No. 510 (R. 71). (He at one time also said that he bought his No. 352 (R. 60), but later said that this bond was billed to William A. Schroeder (R. 62-63) and that his father "spoke to" the seller about the purchase (R. 71).) As a matter of fact, the testimony indicates that William A. Schroeder probably purchased all of Robert's bonds for him (R. 57-58, 63, 68-72), that many were purchased while Robert was a student or out of the country (R. 53, 55, 63, 67; Ex. 7, 10), and that as to four bonds Robert has no records of the purchase (R. 57-58, 59, 65).

Robert Schroeder testified that his first bonds were purchased for him while he was a student, and that his father negotiated the purchase (R. 70-71). Later, before he went into military service, he left money with his father, who was "authorized to make purchases for me out of that money", to spend "the entire amount" (R. 67); Robert simply "told him to use his good judgment" (R. 68). After Robert returned it was

is therefore clear that this case presents the same question that was specifically left undetermined in the *Becker* case.

The importance of this question is four-fold. In the first place, as this case now stands it constitutes a sign-post which points out, for the benefit of any fiduciary who seeks it, the road to evasion of his duties to his beneficiaries. If he has learned from his intimate knowledge of his trust that there is a profit to be made in its securities, this case tells him how to reap that profit for the benefit of his family, even though he knows no court would allow him to gain it for himself. Indeed, this case tells him that if he trades in the securities of his trust for his own account, as well as for his family, and decides simply on the basis of "who had too much cash"[12] whether he will purchase a particular bond for himself, for his wife, for his son, or for his daughter; and if subsequently his own claim is limited to the cost of his bonds—even so, his family will be allowed to retain their profits. In

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no longer necessary for him to give William such broad authority because he shared offices with his father and was engaged with him in the practice of law and the real estate business (R. 63-64), and therefore was available for consultation; but there can be no question that his father acted with his authority in making subsequent purchases for him.

William Schroeder testified that his daughter June Kuptz had money on deposit with him, that she told him that "if I could buy some bonds for her it was O.K.", and that she left it to him to determine the price at which the bonds were to be bought and the amount to be purchased (R. 99); at the time when her bonds were purchased, she lived with her father (R. 100). As to his wife Mollie, Mr. Schroeder testified that "either I or my son bought all the bonds for her, because my wife let me or my son take care of that end of it" (R. 100). It subsequently appeared that he negotiated the purchase of all of her bonds with the possible exception of three which were billed to his son Robert and one which was billed to his son's father-in-law (R. 102-106).

[12] When William Schroeder was asked how it was decided whether a given bond "would be purchased for your wife, your daughter, your son, or yourself", he testified that "the best answer" was that the decision would depend upon "who had too much cash" (R. 112).

view of the large number of proceedings under the Bankruptcy Act which may be expected in the future, and the likelihood that many fiduciaries may seek to follow the road pointed out by this case, it is submitted that this Court should settle for once and for all what rule is to govern their conduct.

The importance of the question is equally clear if it is viewed from the standpoint of the relatives of the fiduciary. In the normal course of things they will know of his position, and perhaps also of opportunities for profit which have come to his attention in his representative capacity. Suppose his wife, or his son, or his daughter, having such information and some funds to invest, prevails upon the fiduciary to purchase some bonds for him or her, and the result is a handsome profit. Is the relative who thus induces the fiduciary to be faithless to his trust, and who stands to gain from the knowledge which the fiduciary acquired in a position of trust and confidence, going to be permitted to reap the profit; or should a court of equity recover it for the fiduciary's beneficiaries? Stated that way this question also merits the attention of this Court.

The result is the same if the question is approached solely in terms of the interests of the former owners of bonds purchased by close relatives of a fiduciary. There is not one word of testimony or any other evidence in this record to show that the former owners of these bonds were given any information whatever in connection of the sale of their bonds.[13] On such a record, and in view of the fact that the fiduciary purchased their bonds for these claim-

[13] Copies of a one-page annual report showing income and expenses but not assets or liabilities were sent to bondholders annually until 1943 by the Committee's trustee (R. 160-161); but there is no evidence that any other information was distributed, either generally or to the seller at the time of any sale transaction. The burden of proof as to this would

ants,[14] what equitable considerations favor these claimants? This Court should decide that.

Finally, the question presented is extremely important because, while the law as to facts like those in the case at bar has never been settled by this Court, the decision by the Court of Appeals tends to cast a shadow over fundamental principles laid down by this Court in other cases in which it has recognized the great public interest in all types of bankruptcy proceedings and in all other proceedings in which it is necessary that "the level of conduct of fiduciaries" be "kept at a level higher than that trodden by the crowd", as Justice Cardozo once so eloquently expressed it.[15] The following quotations make this Court's position as to these principles abundantly clear:

> "The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity."[16]

> "In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate. And its duty so to do is especially clear when the claim seeking allowance accrues to the benefit of an officer, director, or stockholder."[17]

> "It is no answer to say that fraud or unfairness were not shown to have resulted. * * * the incidence of a

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be on the claimants: *Pepper v. Litton,* 308 U.S. 295, 306 (1939); and the burden of proof is of course always upon the trustee to justify the fairness of transactions with his beneficiaries: 1 *Restatement, Trusts,* Sec. 170, p. 431.

[14] See summary of evidence in footnote 11, page 19, *supra.*

[15] *Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 62 A.L.R. 1 (1928).

[16] *Magruder v. Drury,* 235 U.S. 106, 119 (1914).

[17] *Pepper v. Litton,* 308 U.S. 295, 307 (1939).

particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent. Where an actual conflict of interest exists, no more need be shown. * * * "[18]

"This Court has recognized that equity must apply not only the doctrines of unjust enrichment when fiduciaries have yielded to the temptation of self-interest but also a standard of loyalty which will prevent a conflict of interests from arising."[19]

The result in this case manifests no adherence to the principles applied by this Court in those cases. It will be noted that the question which is presented by this case has been stated above in the alternative—should the claims of the fiduciary's close relatives be limited when he purchased their bonds for them either pursuant to a joint enterprise or as their agent? This has been done because, while your petitioner is of the opinion that the evidence clearly establishes that the members of the Schroeder family participated in a joint enterprise, as Judge Kerner specifically held in his dissenting opinion (R. 209),[20] that

[18] *Woods v. City Nat. Bank & Trust Co. of Chicago,* 312 U.S. 262, 268-269 (1941).

[19] *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949). To the same effect as these cases, see also: *American United Mutual Life Insurance Co. v. Avon Park,* 311 U.S. 138 (1940).

[20] In addition to the evidence summarized in the Statement of the Case, page 8, *supra,* and in footnotes 11, page 19, and 12, page 20, *supra,* the following facts are material because they clearly show why the joint enterprise was formed: On June 2, 1938, in the light of all the information about debtor which he then had, Mr. Schroeder agreed with the members of the committee that neither second mortgage bondholders

will presumably be disputed by counsel for these claimants. However, it cannot be disputed that William Schroeder acted under broad express authority from these claimants in purchasing their bonds for them;[21] and, since the purchases extended over a period of more than six years, it must necessarily be inferred that they also ratified and approved his doing so. The importance of the question is such that there should be no risk of the denial of this petition because of any doubt about the sufficiency of the evidence to establish a joint enterprise. The question is the same whether there was a joint enterprise or a course of conduct in which Mr. Schroeder acted for these claimants and they received the benefits of his knowledge and position as a fiduciary.

In either situation it is clear that William Schroeder was guilty of breaches of trust when he purchased the

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nor stockholders had any more equity in the company—in effect, that its assets were owned by the first mortgage bondholders (Ex. 1, p. 57). But the time was not then "ripe" for reorganization, although there had been talk about it in 1936 and 1937 (R. 115), and the committee "tried to hold off until we had enough cash on hand so that we could give a dividend immediately in a reorganization" (R. 112); the plan was that this dividend would be at the rate of $10 per $100 of first mortgage bonds (Ex. 2, p. 149).

Thus the facts in Mr. Schroeder's possession in 1941 may be summarized as follows: He knew that Franklin Building Company was going to be reorganized; that after it was, only the holders of first mortgage bonds would have any interest in it; that they would therefore have control of it; and that as a result his only chance to retain a dominant position in the future depended upon his owning or controlling first mortgage bonds. Furthermore, he must have considered that the purchase of bonds would involve little risk because when the reorganization came there would be an immediate 10% dividend, which would exactly repay the cost of the bonds bought in 1941 and more than repay the cost of those acquired in 1942 (Ex. O).

But there was one complication: Mr. Schroeder "had hardly any money" (R. 103). However, this was not an insoluble problem; for his wife had money (R. 103), his son had money (R. 53), and his daughter had money (R. 98-99). That is why the joint enterprise was formed.

[21] See summary of evidence in footnote 11, page 19, *supra*.

bonds now owned by these claimants, just as he was when he purchased his own bonds, as the District Court held. The law governing trustees and other fiduciaries does not merely require them to exclude their own, personal selfish interest: It also prohibits them from acting in the interest of third persons. The trustee "must exclude all selfish interest and also all consideration of the welfare of third persons";[22] he "is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary";[23] and in reorganization proceedings he must not be allowed "to represent competing classes of creditors or stockholders, or various interests or groups whose purposes and desires are dissimilar", but must be required "to abide by this single standard".[24]

It is not only the fiduciary who is "subject to whatever judicial action may be necessary"[25] if he violates his duty of undivided loyalty to his beneficiaries and the high standard of conduct to which this court has required that

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[22] 3 Bogert, *Trusts and Trustees,* Sec. 543, pp. 375-376.

[23] 1 *Restatement, Trusts,* Sec. 170(1), p. 431.

[24] 6 *Collier on Bankruptcy,* 14th ed., Sec. 9.28, p. 2923.

In addition, in this case bond purchases by William Schroeder after he became a member of the Bondholders Committee constituted breaches of his duty as such to purchase bonds for retirement, for the benefit of all the bondholders. This duty was imposed by Par. 11 of the 1932 Trust Agreement (Ex. 3), which is quoted in footnote 3, page 11, *supra.* Violations of it constituted *additional* breaches of his trust by William Schroeder: 3 Bogert, *Trusts and Trustees,* Sec. 485, pp. 109-111; 1 *Restatement, Trusts,* Sec. 170, Comments j and k, pp. 437-438, and Sec. 206, Comment i, p. 563. There was money available to the Committee to purchase all of the Schroeder bonds bought after March 31, 1946: On that date cash on hand was $8,788.35, and the cash balance increased thereafter (Ex. D, E); the Schroeder bonds bought after that date cost $8,650 (Ex. O), and represent a potential profit of $15,710. Furthermore, even in the absence of funds sufficient to make the purchases for the trust, the trustee is not permitted to buy for himself: *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121, 124 (C.C.A. 2, 1934), cert. den. 294 U.S. 709.

[25] 6 *Collier on Bankruptcy,* 14th ed., Sec. 9.28, p. 2923.

he be held. Those who join with him in his dereliction of duty, even if they otherwise be strangers, are similarly subject to judicial action, and this is particularly true in reorganization proceedings in which "the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done".[26] Two of the Courts of Appeals have specifically so held with respect to third persons who joined with a fiduciary in seeking improper profits from his trust:

> "It seems soundly settled that one who knowingly joins a fiduciary in purchasing for profit the property of the trust estate in unlawful circumstances becomes jointly and severally liable with him for resultant profits."[27]

> "The theory of the suit is that a fiduciary may make no profit for himself out of a violation of duty to his cestui even though he risk his own funds in the ventures and that anyone who assists in the fiduciary's dereliction is likewise liable to account for the profit so made."[28]

Thus, whether these claimants, the wife, son, and daughter of William Schroeder, be regarded as participants with him in a joint enterprise or as his principals, the result must be the same. In either case they have joined with him in his breaches of his duty, and stand to profit from the influence and the intimate knowledge of debtor's affairs that he gained as such a fiduciary. In either case

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[26] *Pepper v. Litton*, 308 U.S. 295, 307 (1939).

[27] *In re Van Sweringen Company*, 119 F. (2d) 231, 234 (C.C.A. 6, 1941), cert. den. *sub nom. Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.*, 314 U.S. 671.

[28] *Irving Trust Co. v. Deutsch*, 73 F. (2d) 121, 123 (C.C.A. 2, 1934), cert. den. *sub nom. Bell v. Irving Trust Company*, 294 U.S. 709. The District Courts have also enforced this rule: *In re Los Angeles Lumber Products Company, Ltd.*, 46 F. Supp. 77 (S.D. Cal., 1941); *In re Jersey Materials Co.*, 50 F. Supp. 428 (N.J., 1943).

they seek for themselves a gain as a result of transactions which he undertook for them at their request, a gain which rightfully belongs to his beneficiaries and not to his family. In either case this decision of the Court of Appeals points the way in which any fiduciary in any arrangement or reorganization proceeding can evade the principles which this Court has held must govern his conduct and can accomplish by indirection for the benefit of his family what he could not directly accomplish for his own benefit. In either case the decision of the Court of Appeals in this case has cast a shadow over the principles which this Court has held to be governing in similar cases.

It is submitted that it is not only important but vitally necessary that this Court strike down this particular example of the "disintegrating erosion of particular exceptions"[29] to those rules which must govern the conduct of trustees if their beneficiaries are to be given the type of representation which alone can safeguard their interests.

## II.

## This Decision is in Conflict With the Decisions of the Courts of Appeals for the Second Circuit in Irving Trust Co. v. Deutsch and for the Sixth Circuit in In Re Van Sweringen Co.

It was pointed out in the preceding section of this argument that in purchasing their bonds for these claimants, William Schroeder was guilty of breaches of his duty as a fiduciary;[30] and that under the law as established by the Courts of Appeals for the Second and Sixth Circuits in

[29] *Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 62 A.L.R. 1 (1928).

[30] Page 25, *supra,* and authorities cited.

cases in which this Court refused certiorari,[31] these claims must be limited because the claimants joined with him in those breaches of his trust. Since the Court of Appeals for the Seventh Circuit held that these claims should not be limited, its decision in this case is in conflict with the decisions of those two courts and an additional reason is presented for this Court to review the decision in this case.

The participation of these claimants in the breaches of trust of this fiduciary was at least as great as the participation of the third parties in the breaches of trust of the fiduciaries in those cases.

In *Irving Trust Co. v. Deutsch* the facts were that the debtor corporation had hired one Bell to negotiate the purchase for debtor of stock in another company, which he did. When the time for payment came, debtor could not complete the purchase. Instead, debtor's directors and Bell bought the stock for themselves, with their own funds, and later resold it at a substantial profit. Debtor's trustee in bankruptcy sued to compel Bell and the directors to account for their profits, and it was held that all of them, including Bell, must do so. As to Bell the court said:

> "The theory of the suit is that a fiduciary may make no profit for himself out of a violation of duty to his cestui even though he risk his own funds in the ventures and that anyone who assists in the fiduciary's dereliction is likewise liable to account for the profit so made."[32]

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[31] *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121 (C.C.A. 2, 1934), cert. den. *sub nom. Bell v. Irving Trust Company,* 294 U.S. 709; and *In re Van Sweringen Co.,* 119 F. (2d) 231 (1941), cert. den. *sub nom. Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.,* 314 U.S. 671.

[32] 73 F. (2d) at page 123. The court here cites cases, including *Jackson v. Smith,* 254 U.S. 586 (1921), which, while the facts are

not exactly the same as those in the case at bar, is highly important in demonstrating that this Court has given its approval to the general principle applied by the Courts of Appeal in the *Irving Trust Co.* and *Van Sweringen Co.* cases.

In *Jackson v. Smith* it appeared that Ambrose, a court-appointed receiver, had, after the first attempted sale of a note secured by a trust indenture belonging to the debtor, prevailed upon the trustee under the indenture to arrange a second sale in the hope of obtaining a higher bid. Before the second sale it was agreed between Ambrose, Wilson, a stranger to the proceedings, and Smith, attorney for Ambrose, that Wilson would appear at the second sale and use his own judgment as to bidding, and that if he was successful all three would share in ownership of the note. The sale was held, and affirmatively shown to have been a fair public sale. Wilson was the highest bidder, and subsequently voluntarily raised his bid so that the sale would produce enough to clear the land of tax liens. Before taking title, Wilson resold the note at a profit which was divided with Ambrose and Smith. A subsequent receiver brought action against Smith and Wilson only, not Ambrose, to recover the profit made on resale of the note, and it was held that he could recover the entire profit, including that obtained by the receiver Ambrose. The court said:

"When he [Ambrose, the receiver] agreed with Smith and Wilson to join in the purchase if Wilson should become the successful bidder, he placed himself in a position in which his personal interests were, or might be, antagonistic to those of his trust. Michoud v. Girod, 4 How. 503, 552, 11 L.Ed. 1076. It became to his personal interest that the purchase should be made by Wilson for the lowest possible price. The course taken was one which a fiduciary could not legally pursue. Magruder v. Drury, 235 U.S. 106, 119, 120, 35 Sup. Ct. 77, 59 L.Ed. 151. Since he did purchase it and profits resulted the law made him accountable to the trust estate for all the profits obtained by him and those who were associated with him in the matter, although the estate may not have been injured thereby. Magruder v. Drury, 235 U.S. 106, 35 Sup. Ct. 77, 59 L.Ed. 151. And others who knowingly join a fiduciary in such an enterprise likewise become jointly and severally liable with him for such profits. Emery v. Parrott, 107 Mass. 95, 103; Zinc Carbonate Co. v. First National Bank, 103 Wis. 125, 134, 79 N.W. 229, 74 Am. St. Rep. 845; Lomita Land & Water Co. v. Robinson, 154 Cal. 36, 97 Pac. 10, 18 L.R.A. (N.S.) 1106. Wilson and Smith are therefore jointly and severally liable for all profits resulting from the purchase; the former although he had no other relation to the estate; the latter, without regard to the fact that he was also counsel for the receiver. * * * Smith and Wilson are held liable for knowingly confederating with one who, as receiver of the estate of the note holder, owed a duty to it, and who put himself in a position where his personal interest conflicted with his duty." (254 U.S. at pages 588-589).

The court noted that he had been an agent, and that he claimed his agency had terminated, and went on to make it perfectly clear that the decision was based squarely upon his participation with the directors, and that the agency relationship was immaterial:

> "But, even if the fact of his agency be disregarded, we think there is an applicable principle which requires him to account, namely, that one who knowingly joins a fiduciary in an enterprise where the personal interest of the latter is or may be antagonistic to his trust becomes jointly and severally liable with him for the profits of the enterprise."

In *In re Van Sweringen Company* the facts were that the fiduciary directors and two outsiders, Tomlinson and Ball, joined to purchase claims against the debtor at a discount, and did so through a corporation which actually purchased them. Despite the fact that limitation of the corporation's claim would affect Tomlinson and Ball as its stockholders, as well as the fiduciaries, the claim was limited to cost. The court said:

> "It seems soundly settled that one who knowingly joins a fiduciary in purchasing for profit the property of the trust estate in unlawful circumstances becomes jointly and severally liable with him for resultant profits."[33]

[33] 119 F. (2d) at page 234. The *Van Sweringen* case, involving as it does the purchase of claims by a corporation created by the fiduciaries for the purpose, is much like *In re Norcor Mfg. Co.*, 109 F. (2d) 407 (1940), cert. den. 310 U.S. 625, which was decided by the same Court of Appeals that decided this case. In the *Norcor* case the claim involved was purchased by a corporation owned and dominated by the attorney for the managing agent of the debtor. This Court of Appeals held that the claim must be limited to cost, saying:

> "As Krueger occupied a fiduciary relation, so did his attorney Lehner. Neither of them would have been entitled to the allowance of a claim in an amount which would have inured to his individual profit. Being thus precluded as individuals, they had no right to accomplish the same purpose under the guise of a corporate entity." (109 F. (2d) at page 411).

In this case, as the evidence previously summarized[34] establishes, these claimants joined with William Schroeder in the purchase of their bonds. They gave him broad authority to make purchases for him at prices, in amounts, and from persons indicated by his "good judgment".[35] The ultimate owner of the bonds was that person "who had too much cash".[36] What is more, they were his close relatives and thus their profits would inevitably, if indirectly, redound to his benefit; this adds a factor not present in the *Irving Trust* and *Van Sweringen* cases.

It is therefore submitted that the facts in this case bring it squarely within the rules of the cases decided by the Courts of Appeals for the Second and Sixth Circuits, and that the decision in this case accordingly is in conflict with those decisions. This provides a second reason why this Court should review this case.

## III.

## This Decision is in Conflict With the Decision of the Court of Appeals for the Third Circuit in In Re Midland United Co.

In the preceding sections of this argument these claims have been tested in the light of the principles of equity which are applied in reorganization proceedings independently of the Bankruptcy Act. The point made in this section of the argument is that Section 212 of the Act[37]

[34] Statement of the Case, pages 8 to 17, *supra.*

[35] See evidence summarized in footnote 11, page 19, *supra.*

[36] Testimony of William Schroeder (R. 112).

[37] 11 U.S.C.A., Sec. 612:

"The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture

also requires limitation of these claims and that the decision of the Court of Appeals in this case in which it refused to limit them is contrary to the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.*, 159 F. (2d) 340 (1947).

In that case that Court of Appeals affirmed an order of the District Court denying all compensation to the attorney for a protective committee for a senior security. Both the attorney, Harold Evans, and his wife had purchased securities of a subsidiary of the debtor. The decision is based both upon Section 249 of the Bankruptcy Act and upon equitable principles governing the allowance of compensation to fiduciaries. As to Section 249,[38] the court held:

> "Sight must not be lost, however, of the fact that Section 249 not only prohibits trading in 'the stock of, the debtor', but also specifically enjoins allowance of compensation where 'a beneficial interest, direct or indirect, has been acquired or transferred

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trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

[38] 11 U.S.C.A., Sec. 649:

"Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

* * *' by any person seeking compensation for services rendered in a reorganization proceeding in *'claims against, or stock of, the debtor.'*

"The facts disclose that there was violation of the latter provision of Section 249 when Mr. Evans bought the preferred stock of NIPSCO and Mrs. Evans bought the preferred stock and bonds of NIPSCO because at the time of these purchases NIPSCO had disputed and undisputed claims against Utilities [the debtor] of some $3,569,000 exclusive of interest. In purchasing these securities of NIPSCO it is obvious that the Evans were indirectly purchasing a beneficial interest in 'claims against * * * the debtor' Utilities." (159 F. (2d) at page 345.)[39]

[39] As to the equitable principles which the court held also required prohibition of compensation to Mr. Evans, it said:

"It will be noted that we have regarded Mrs. Evans' transactions as being in the same category as those of Mr. Evans. While she financed her securities dealings entirely with her own funds, Mr. Evans candidly stated that she engaged in the various transactions with his 'entire approval and knowledge.' Under such circumstances it is clear that the bankruptcy court was justified, in the exercise of its proper powers, in extending the principles applicable to the conduct of the fiduciary to the fiduciary's wife. The settled rule in equity is that where a fiduciary is barred from compensation the prohibition extends to his wife: *Holman v. Ryan,* 1932, 61 App. D.C. 10, 56 F. (2d) 307, 311 and cases collected in 131 A.L.R. 990 (1940)." (159 F. (2d) at page 347).

In this aspect the *Midland United* case is in accord with *Berner v. Equitable Office Bldg. Corporation,* 175 F. (2d) 218 (1949), in which the opinion was written by Chief Judge Learned Hand. In that case the court referred to the *Midland United* case as establishing that "in some jurisdictions a purchase by the trustee's wife is ipso facto invalid" (page 221). The court did not agree with this construction of Section 249, but held that:

"Even were this not a general principle of the law of trusts, since Congress has seen fit in corporate reorganizations to impose so drastic a penalty as the forfeiture of all compensation upon any purchase whatever by an attorney—or other fiduciary—on his own account, we should fail to give proper scope to that purpose, if we were to say that he might freely favor a relative, or indeed even a friend, with information of a probable rise in price of the debtor's shares which was unknown to the shareholders. We hold that

In this case the Court of Appeals refused to apply Section 212 to these claimants despite the fact that they are related to Mr. Schroeder as closely as Mrs. Evans was to Mr. Evans in that case. It is submitted that the decisions are therefore in conflict because the same tests should be applied with respect to the limitation of claims under Section 212 as are applied with respect to the denial of compensation under Section 249.

At the time that the present Bankruptcy Act containing Sections 212 and 249 was adopted, Congress considered that the jurisdiction and powers of the Bankruptcy Courts "were still far too restricted to afford adequate relief" under the existing law, and that there was a "lack of adequate judicial control".[40] The legislative objective was to broaden the control of the court over all aspects of the reorganization proceedings, and the result was the passage of Sections 209-213 and 249, all of which were designed to accomplish that objective.[41] "The legislative intention was that these powers should be employed wherever necessary to protect the rights of the individual investor."[42]

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this is what Berner did, and that in so doing he committed a breach of trust to the shareholders of whom Bell bought. Nevertheless, since Congress limited the penalty of entire forfeiture to purchases by a fiduciary, we should not be warranted in extending that penalty to the situation at bar; and we think that the consequences should be only those which attend any breach of trust in equity: i.e., that in determining what the trustee's compensation shall be, the court will as a matter of discretion diminish the allowance which it would otherwise make, in proportion to the gravity of the breach." (175 F. (2d) at pages 221-222).

[40] House Report No. 1409, 75th Cong., 1st Sess. (1937), p. 37.

[41] 6 *Collier on Bankruptcy*, 14th ed., Sec. 9.28, pp. 2920-2922, and Sec. 13.18, pp. 4584-4585.

[42] *Ibid*, pp. 2921-2922. The same author further states (page 4590):

"Considering the rigorous purpose of the statute and the realities of life, the preferable view would seem to be that aside from ex-

Since the two sections were enacted for the same purpose, they should receive the same construction. They are alike in that neither mentions close relatives of the various types of fiduciaries who are mentioned. They are alike in that both had the effect of broadening the powers of the court.[43]

It has been said that "Chapter X enables the reorganization judge to exact of representative agencies or bodies a standard of personnel and conduct which attains the fullest measure of protection to the principal, secures a conscientious representation of his interests, and which is responsive to his rights and needs alone."[44] If Section 249 has that effect by virtue of prohibiting compensation to a fiduciary whose close relatives trade in the debtor's securities, will not Section 212 have precisely the same effect if it is construed to prohibit those same persons from reaping profits with the aid of the fiduciary? What essential difference is there, if the matter is viewed realistically, between denying him compensation because he assisted his wife in trading in his debtor's securities, and denying her the fruits of such trading for exactly the same reason? Can anyone seriously contend that his knowledge that either one of those consequences would follow from his participation in his wife's trading would not have the same effect as knowledge of the other, namely, to tend to cause him not to trade in the securities of his trust?

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ceptional circumstances—as, for example, an estranged spouse trading in the securities independently—such transactions should be disqualifying; otherwise 'a fertile field would be opened to a fiduciary to profit the members of his family and thus enhance his own economic position by reason of his status as a beneficiary'."

[43] 6 *Collier on Bankruptcy,* 14th ed., Sec. 9.31, p. 2929, and Sec. 13.18, pp. 4584-4586.

[44] *Ibid,* Sec. 9.31, pp. 2933-2934.

That is the heart of the matter. Section 212 must be construed the same as Section 249 because only if it is so construed will it fully accomplish its purpose. If it is not so construed, this is what a fiduciary could do if his knowledge of the debtor indicated that there was a profit to be made in its securities: He could make a large gift to his wife, and thus provide her with funds to be used in trading in the debtor's securities; he could purchase such securities for her, using her funds, and thus produce a profit of many times the amount of compensation he could expect to receive for his services; and then he could waive his claim for compensation, knowing that it would be disallowed anyway under Section 249 as that section has been construed, and go on his way, laughing at Congress and the safeguards it sought to place in the Bankruptcy Act.

It is therefore submitted that, since Section 212 and Section 249 must both be construed to apply to a situation in which a fiduciary participates in trading by his family, the decision of the Court of Appeals in this case is in conflict with the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.* This provides a third reason why this Court should review this case.

## CONCLUSION

It is submitted that there are three valid reasons why this Court should grant certiorari in this case:

1. Because this case presents a question which (a) has great importance in the administration of the Bankruptcy Act; (b) should be finally settled by this Court; (c) has been decided by the Court of Appeals for the Seventh Circuit in a way which is inconsistent with the governing principles laid down by this Court; and (d) has been

decided in a way which conflicts with decisions of other Courts of Appeals.

2. Because the decision in this case is in conflict with decisions of the Courts of Appeals for the Second and Sixth Circuits; and the latter are consistent with the decisions of this Court.

3. Because the decision in this case is contrary to a decision of the Court of Appeals for the Third Circuit; and the latter gives effect to the purpose for which Sections 212 and 249 of the Bankruptcy Act were adopted.

Dated at Milwaukee, Wisconsin, April 14, 1950.

*Respectfully submitted,*

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